No. 675

In the Supreme Court of the United States

OCTOBER TERM, 1957

RAYMOND S. MILLER AND JOSEPHINE MILLER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

FRANK NOWATZKI AND LILLIAN NOWATZKI, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court are reported at 26 T.C. 151. The opinion of the Court of Appeals (Pet. 1a-6a) is reported at 247 F. 2d 206.

JURISDICTION

The judgments of the Court of Appeals were entered on July 9, 1957. (R. 61-62.) The taxpayers' petition for rehearing filed with the Court of Appeals was denied on September 20, 1957. (R. 63.) The petition for a writ of certiorari was filed on December 19, 1957. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Whether the court below erred in holding that, under the terms of a contract for the sale of stock and the surrounding circumstances, a dividend paid on the stock and applied against the purchase price constituted dividend income to the purchasers, not to the seller.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1952 ed., Sec. 22 (a).)

STATEMENT

The facts, as found by the Tax Court (R. 32-40), may be summarized as follows:

The seller[1] was the owner of 45,000 shares of a total of 46,700 shares of issued and outstanding stock of Tiny Tot Safety Table Company, an Illinois corporation. (R. 32.)

On July 29, 1950, the seller entered into a written contract with the buyers providing for the sale of his stock in the Company. (R. 32.) The written agreement in pertinent part reads as follows (R. 32-33, 34-35):

> 1. Seller hereby sells, assigns and delivers to Buyers 45,500 shares of stock of the Corporation and all his rights in letters patent No. 2461123 not heretofore assigned to the Corporation.
>
> 2. Said 45,500 shares of stock of the Corporation are herewith redelivered to Seller and reassigned by Buyers to Seller as collateral security for the payment of Forty-three Thousand Five Hundred ($43,500.00) Dollars as hereinafter provided.
>
> 3. Buyers have made an initial payment of Two Thousand ($2,000.00) Dollars, receipt of which is hereby acknowledged by Seller. Buyers agree to pay to Seller the balance of Forty three Thousand Five Hundred ($43,500.00) Dollars as follows:
>
> (a) The sum of Ten Thousand ($10,000.00) Dollars shall be paid by Buyers to Seller on or before August 15, 1950;

[1] The term "seller" refers to Clarence W. Miller, and the term "buyers" refers to the petitioners Raymond S. Miller and Frank Nowatzki, all of whom were parties to the consolidated proceedings in both the Tax Court and the Court of Appeals. Since their wives are parties only because joint returns were filed for the taxable year, the terms do not have reference to them.

(b) Cash of the Corporation on hand at the close of business on July 31, 1950, less accounts payable as shown on balance sheet as of July 31, 1950, hereinafter referred to, and a further amount in cash equivalent to the amounts due to the Corporation from Tiny Tot Safety Table, Eastern Co., as of the close of business on July 31, 1950, are to be distributed to the shareholders pro rata—through reduction of stated capital and liquidating dividend or through means approved by the Secretary of State—and amounts received thereby on the 45,500 shares of Seller are to be paid to seller and shall apply on or reduce said sale price in such amount;

* * * * *

4. As a condition precedent to this agreement becoming effective, Seller and the Corporation shall furnish Buyers with a certified balance sheet, made by the Auditor of the Corporation, as of the close of business on July 31, 1950, which balance sheet shall be accepted by Buyers as their understanding of the status of the Corporation. Seller shall warrant on said balance sheet that it is true and correct. Should liabilities arise on transactions made prior to July 31, 1950, or on matters which occurred prior to July 31, 1950, Seller shall be liable therefor to the extent that his 45,500 shares (being sold hereby) bears a proportionate part to the 46,700 shares issued and outstanding as of the date of this agreement.

5. Seller, in addition to the provisions of said collateral installment note, which he may exercise independently of the provisions hereof, shall have the following rights:

(a) Seller shall vote the shares of stock of the Corporation held by him as collateral as fully and completely as though he were the owner thereof;

(b) Seller shall elect two of the five directors of the Corporation so long as Buyers are not in default in the making of payments hereunder, and so long as Buyers are not guilty of a breach of any agreement hereunder; and Seller shall elect three of the five directors should Buyers be in default for twenty days or more in the making of any payment hereunder or be guilty of a breach of any agreement hereunder;

(c) The balance due shall at all times be a first and prior lien on the earnings of Buyers with the Corporation;

(d) Should there be default in the making of any payment, the Corporation shall make no payment to Buyers for salary or commission;

(e) Buyers will at no time bind the Corporation to any obligation of any kind, nor will they cause any of the assets of the Corporation to be subjected to any lien or mortgage of any kind, without the written consent of Seller;

(f) Until Buyers have paid Seller in full, disbursements of the Corporation for rent, sal-

aries and other expenses shall not exceed $1,500.00 a month, unless Seller shall agree in writing to disbursements in excess thereof;

(g) Until Buyers have paid Seller in full, Buyers shall make no loan from the Corporation;

(h) Buyers shall furnish the necessary working capital for the Corporation should funds other than earnings be needed;

(i) Until Buyers have paid Seller in full, the Corporation will not issue additional shares;

(j) The certificates of stock to be held as collateral shall bear a legend that the certificates are subject to all of the terms and conditions of this agreement;

(k) Buyers shall have the right to pay off the entire amount owed by them to Seller at any time, without premium.

* * * * *

The contract was signed by the parties, and again by the seller as president of Tiny Tot Safety Table Company. (R. 36.) On July 29, 1950, the directors of the corporation held a meeting at the office of the corporation for the purpose of considering the agreement made between the seller and the buyers and to consider a declaration of dividends. (R. 22.) The minutes of that meeting, in pertinent part, read as follows (R. 37):

Be It Resolved, Therefore, that the president and secretary of this corporation, be, and they are hereby authorized, empowered and instructed on

behalf of this corporation to enter into and execute the agreement made this 29 day of July, 1950, by and between Clarence W. Miller, as seller; Raymond S. Miller, and Frank Nowatzki, as buyers, and this corporation, copy of which agreement is attached following minutes of this meeting.

The directors noted the provision in the above agreement that it was contemplated a liquidating dividend would be declared by the corporation and that such liquidating dividend would apply on or reduce the sale price in such amount. A check of the books showed an earned surplus account about the size of the bank account. This surplus had been retained for working capital deemed necessary because of changes in the main product of the corporation, the development of optional extension legs and problems of manufacture, storage and warehousing throughout the country on credit sales. The directors noted further that Raymond S. Miller and Frank Nowatzki have obligated themselves to supply necessary working capital for the corporation should funds other than earnings be needed. In view of the above, on motion duly made and seconded, the following resolution was unanimously adopted:

> Resolved that the Board of Directors of Tiny Tot Safety Table Co. declare a dividend of 58¢ a share on the outstanding 46,700 shares of the capital stock of this corporation to stockholders of record on July 28, 1950, payable August 4, 1950, out of the earnings or surplus of this corporation.
>
> Resolved Further, that no recommendation be made to the shareholders for the declaration of

> any liquidating dividend, the parties to the agreement attached following these minutes having approved this resolution.
>
> * * * * *

The buyers' approval of the declaration of the dividend was registered on the margin of the last page of the minutes. (R. 38.)

On August 4, 1950, the seller executed the following assignment (R. 38):

> For Value Received, I hereby sell, assign and transfer unto Frank M. Nowatzki and Raymond S. Miller 45,500 shares of stock of Tiny Tot Safety Table Company, represented by the following certificates:
>
> > [Listing of names on share certificates, the numbers of the shares, and the number of shares in each name]
>
> * * * * *

The seller received the dividend mentioned in the minutes in the form of two checks dated August 7, 1950. (R. 39.)

In their returns for 1950, made jointly with their wives, the buyers did not report the dividend as income received by them. In his notices of deficiency, the Commissioner included one-half of the amount of the dividend in the income of each buyer. (R. 39.)

In his return for 1950, made jointly with his wife, the seller reported the dividend as a net long-term capital gain from the sale of his stock. In his notice of deficiency, the Commissioner disallowed the capital

gains treatment and treated the amount of the dividend as ordinary income. (R. 39.)

The Tax Court held that the dividend was taxable as such to the seller, not to the buyers. (R. 40-48.) The seller appealed and, in order to protect the revenue, the Commissioner filed protective cross-appeals in the cases of the buyers. The Court of Appeals reversed (one judge dissenting), holding that the dividend was taxable to the buyers and that, as to the seller, the dividend represented a portion of the purchase price (taxable as capital gain). (Pet. 1a-6a.)

ARGUMENT

1. It is settled that taxation is not so much concerned with refinements of title as with the beneficial ownership of property or its income. *Griffiths* v. *Commissioner*, 308 U. S. 355, 357. Accordingly, the determination of who is taxable on dividends paid on shares of stock which are the subject of an executory contract of sale—the seller or the buyer—depends upon which of them derived the economic benefit of the payment, and this in turn depends upon a practical view of the contract and the circumstances of the particular case, no one circumstance being controlling. *Northern Trust Co. of Chicago* v. *United States*, 193 F. 2d 127 (C.A.7th), certiorari denied, 343 U. S. 956; *DeGuire* v. *Higgins*, 159 F. 2d 921 (C.A.2d), certiorari denied, 331 U. S. 858; *Moore* v. *Commissioner*, 124 F. 2d 991 (C.A.7th).

Both courts below agreed with these principles but differed as to the construction to be placed upon the documents as a whole, each emphasizing different provisions and circumstances. While we believe that the Tax Court's conclusion that the seller remained the

beneficial owner of the stock is a reasonable one (since at the time of the dividend the seller not only retained legal title but the right to vote the stock), and so contended in the court below, it cannot be said that the contrary interpretation adopted by the Court of Appeals is not also a permissible one.

The Court of Appeals placed great emphasis on the facts that the contract provided that the dividend should be applied against the purchase price and that the buyers approved the dividend. (Pet. 4a, 5a.) The fact that the seller, according to the contract, merely held the stock as security for payment of the purchase price until he was credited with the dividend was also considered significant by the Court of Appeals. These uncontroverted facts furnish substantial support for its conclusion that the dividend was paid to the seller not as a dividend, but as part of the purchase price due him under the contract of sale, and, therefore, that the buyers received the actual benefit for which the tax should be paid. (Pet. 4a.) The conclusion it reached is consistent with cases which hold that the seller of stock is not liable for the ordinary dividend tax when he does not receive the dividend as such, but as part of the purchase price under the contract of sale. *Northern Trust Co. of Chicago* v. *United States*, 193 F. 2d 127 (C.A.7th), certiorari denied, 343 U. S. 956; *Moore* v. *Commissioner*, 124 F. 2d 991 (C.A.7th).

Since the question in this type of case is essentially factual, and since the decision of the Court of Appeals is a reasonable one, we submit that the issue presented is not one that warrants review by this Court.

2. There is no conflict of decisions. Since determination of the question depends upon the construction of the particular agreement in issue and the peculiar facts

of the case, petitioners' contention (Pet. 8-9) that the decision below is contrary to the decisions in *Northern Trust Co. of Chicago* v. *United States*, 193 F. 2d 127 (C.A. 7th), certiorari denied, 343 U.S. 956, and *Moore* v. *Commissioner*, 124 F. 2d 991 (C.A. 7th), is plainly without merit. Moreover, those cases were decided by the same court that decided the present case and, as pointed out *supra*, they are in accord with the instant decision in principle.[2]

There is likewise no conflict with *Shinsaku Nagano* v. *McGrath*, 187 F.2d 753 (C.A. 7th) (Pet. 5); *Buchanan* v. *National Savings & Trust Co.*, 23 F. 2d 994 (C.A. D.C.) (Pet. 6); *In re Sutherland*, 23 F. 2d 595 (C.A. 2d) (Pet. 5); *Saulbine* v. *Stroud*, 5 F. 2d 809 (C.A. 8th) (Pet. 5); and *Bowers* v. *Post*, 209 Fed. 660 (N.D. Ill.), affirmed *per curiam*, 220 Fed. 1006 (C.A. 7th) (Pet. 4), none of which are tax cases. Those cases apply the general principle that a corporate dividend belongs to the owner of shares at the time of the dividend, and concern themselves with the question of legal title to shares of stock under local law. As stated previously, tax liability under the revenue statutes is not dependent upon refinements of legal title; although possession of legal title is an item to consider in the determination of the present controversy, it is not at all controlling.

The same observations hold true for petitioners' reliance (Pet. 6-7) on *Burke* v. *Dulaney*, 153 U. S. 228;

[2] Petitioners also rely (Pet. 8) upon *DeGuire* v. *Higgins*, 159 F.2d 921 (C.A. 2d), certiorari denied, 331 U.S. 858, but that decision merely concerned the buyer in the same transaction involved in *Moore* v. *Commissioner*, 124 F. 2d 991 (C.A. 7th). In the *Moore* case, the Seventh Circuit decided that the dividend in question was not taxable to the seller of the stock, and the Second Circuit in the *DeGuire* case followed the *Moore* case and taxed the dividend to the buyer. The decision below is thus in complete accord with that decision.

Jones v. *United States*, 96 U.S. 24; and *Getz* v. *City of Harvey*, 118 F. 2d 817 (C.A. 7th), certiorari denied, 314 U. S. 628, which likewise are not tax cases but concern causes of action *ex contractu*, dealing merely with the interpretation of conditions precedent found in ordinary contracts.

CONCLUSION

The case presents a factual question the disposition of which is dependent upon the terms of a particular agreement and set of surrounding circumstances. There is no conflict of decisions. Accordingly, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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